

Charitable Contributions

Facade Easement Deductions Remain Viable With Local Rules, but Require Good Appraisal

Property owners can still claim a charitable contribution deduction for the grant of a facade conservation easement encumbering a building subject to local historic preservation regulations.

They just need a very good appraisal to back it up, tax practitioners who regularly represent conservation easement donors told Bloomberg BNA.

“It’s not for the faint of heart,” Ronald Levitt of Siroto & Permutt PC in Birmingham, Ala., said Nov. 13.

Tax code Section 170(h) allows a deduction for the reduction in value of a historic structure caused by an easement requiring preservation of the facade of the structure and granted to a qualified organization. The statute requires that the structure either be listed in the National Register of Historic Places or be located in a registered historic district.

Facade easement deductions are sometimes criticized as a tax break for the rich. Chris Moss of Infinite Partnerships in Alexandria, Va., in a Nov. 13 interview, called facade easements “‘charitable inversions,’ because they invert the original purpose of charity.”

Frank Agostino of Agostino & Associates in Hackensack, N.J., said Nov. 18 that he is a “true believer” in the private preservation intent of facade easements. Agostino has represented several taxpayers in New York and Boston defending their facade easement deductions against Internal Revenue Service challenges.

Technical Challenges. The IRS has been aggressively challenging deductions for facade conservation easements for several years. In 2005 and 2006, the Service went as far as to list the deductions on their annual “Dirty Dozen” list of tax scams.

The Service dropped facade easements from the Dirty Dozen after the Pension Protection Act of 2006 (Pub. L. No. 109-280) amended Section 170 to require the entire exterior of the structure be protected and set higher standards for appraisers.

The IRS initially attacked facade easement deductions based on technicalities of the taxpayers’ valuations in such cases as *Whitehouse Hotel LP v. Commissioner*, 615 F.3d 321, 2010 BL 183943 (5th Cir. 2010); *Simmons v. Commissioner*, T.C. Memo. 2009-208 (9/15/09), *aff’d* 646 F.3d 6, 2011 BL 164327 (D.C. Cir.

2011); and *Scheidelman v. Commissioner*, 682 F.3d 189, 2012 BL 147756 (2d Cir. 2012).

In *Simmons and Kaufman v. Commissioner*, 687 F.3d 21, 2012 BL 180291 (1st Cir. 2012), the Service also argued that the easements weren’t in perpetuity, as required by the tax code, based on a provision that allowed the donee to abandon the easement. In *Kaufman*, the IRS further claimed that a lender’s subordination invalidated the easement.

Local Restrictions. After losing in the U.S. Courts of Appeals on its technical claims, the IRS pursued a litigation strategy of arguing that a conservation easement doesn’t reduce the value of the property if the property was already subject to local historic preservation regulations.

On remand to the U.S. Tax Court in *Kaufman v. Commissioner*, T.C. Memo. 2014-52, 2014 BL 88981 (3/31/14), the IRS had no trouble convincing Judge James S. Halpern that the easement was no more restrictive than the standards and criteria of the Boston South End Historic District.

“It comes down to getting a qualified appraiser to do a qualified appraisal. In some cases the easement doesn’t add to the local restrictions—and sometimes it does.”

FRANK AGOSTINO
AGOSTINO & ASSOCIATES

The IRS also argued in its brief in Huda Scheidelman’s second appeal to the U.S. Court of Appeals for the Second Circuit that the facade easement on her Brooklyn townhouse was no more restrictive than the New York City Landmarks Preservation Commission’s (LPC’s) regulations for the historic Fort Greene neighborhood where the home was located.

In *Scheidelman v. Commissioner*, 755 F.3d 148, 2014 BL 168874 (2d Cir. 2014), the Second Circuit upheld Tax Court Judge Mary Ann Cohen’s acceptance of the IRS’s reports, which “although flawed” showed the easement didn’t reduce the value of Scheidelman’s property.

On its website page regarding conservation easements, last updated in April 2014 (<http://www.irs.gov/Charities-&-Non-Profits/Conservation-Easements>), the Service said that “if the facade was already subject to restrictions under local zoning ordinances, the taxpayers may, in fact, be giving up nothing, or very little. A taxpayer cannot give up a right that he or she does not have.”

Regarding the IRS website, Levitt said, “Just because the IRS says something, doesn’t make it so. There are often exceptions given to local regulations. The LPC’s rules are meant to protect the local gestalt. It isn’t bound by its guidelines.”

‘Bait and Switch.’ Agostino said “it’s bad policy to go after the taxpayers.” Many of the taxpayers in the decided cases were among the first to participate in the incentive and did so in good faith. They wanted to help preserve the character of their neighborhoods. They paid for what they thought were good appraisals, he said.

The deduction was marketed by easement organizations to promote private preservation. “Then the IRS disallowed all the easement deductions,” Agostino said. He called it “bait and switch.”

Many of the challenged easements were granted to the National Architectural Trust (NAT), and many of the taxpayers used appraisers recommended by the NAT. Levitt noted that “the government has been very aggressive in New York and Boston because of NAT. Taxpayers elsewhere have been successful.”

The NAT was permanently enjoined by a federal district court judge in 2011 from promoting a scheme that encouraged taxpayers in several major East Coast cities to claim \$1.2 billion in unwarranted deductions for donations of facade conservation easements on historic buildings (138 DTR K-2, 7/19/11).

Viability Going Forward. “Facade easements are still viable despite the government’s current litigating position,” Anson Asbury of the Asbury Law Firm in Atlanta said Nov. 10.

“Not all local historic districts have the same preservation laws. The value of a conservation easement—facade or open space—should be determined on a case-by-case basis. The restrictions imposed under local law are only one factor to be considered,” Asbury said.

Asbury cited *Simmons*, saying “the case was an example where the IRS didn’t prevail. The Tax Court found that facade easements in Washington affected the properties’ fair market value, because the easements were subject to a higher level of enforcement, approval and intervention than the D.C. laws.”

Additional Diminution in Value. Levitt and Agostino both emphasized the importance of a good appraisal. Levitt said an appraisal “must show that it’s reasonably probable that the locality will allow changes,” and that the easement caused a diminution in value.

Agostino said “it comes down to getting a qualified appraiser to do a qualified appraisal. In some cases the

easement doesn’t add to the local restrictions—and sometimes it does.”

Agostino also noted that the easement documents used by the donee organizations in the Boston area require the homeowner to carry replacement cost insurance as opposed to reproduction cost. This means if the facade is damaged or destroyed, the same type and quality of materials must be used for restoration, he said.

Asbury said the court in *Simmons* also found that the easement dictated the use of specific materials and supplies when making repairs to the encumbered properties.

Agostino said the quality of appraisals is improving, because there are now comparables. In addition, the early easements where the taxpayers lost were granted “when the real estate market was hot, and the easements weren’t a drag on value.” In the current market, the easements are affecting the price, he said.

**Facade easements are “ ‘charitable inversions,’
because they invert the original purpose of
charity.”**

CHRIS MOSS
INFINITE PARTNERSHIPS

Policy Considerations. Congress had the opportunity to eliminate deductions for facade easements in 2006 and instead chose to tighten the requirements. Despite the IRS’s apparent dislike for the deduction and some abuse, Congress effectively ratified the deduction.

Moss disagreed with that action. He said Congress “should get rid of the deduction and instead create a historic preservation credit that would be in addition to the historic rehabilitation credit.” Moss said it would be preferable to have the National Register administer the credit instead of all of the trusts.

Agostino expressed a different view. He likes “the idea of a private partnership. The government should encourage private activity. The charitable organizations are paying the price of inspections and doing things that building departments can’t do. The IRS has tried to eliminate that.”

Agostino said the government really isn’t losing that much, because the U.S. Treasury gets capital gains tax on the deducted value when the grantors sell as a result of the reduction in basis when the deduction was claimed.

By ERIN McMANUS

To contact the reporter on this story: Erin McManus in Washington at emcmanus@bna.com

To contact the editor responsible for this story: Brett Ferguson at bferguson@bna.com

To request permission to reuse or share this document, please contact permissions@bna.com. In your request, be sure to include the following information: (1) your name, company, mailing address, email and telephone number; (2) name of the document and/or a link to the document PDF; (3) reason for request (what you want to do with the document); and (4) the approximate number of copies to be made or URL address (if posting to a website).